

PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

ENERGY DIVISION

**RESOLUTION E-3929
April 7, 2005**

R E S O L U T I O N

Resolution E-3929. Pacific Gas and Electric ("PG&E") requests Commission approval of a three-year physical tolling agreement beginning in 2005 through December 2007 with Duke Energy Marketing Americas ("Duke" or "DEMA"). PG&E's request is approved with modifications.

By PG&E Advice Letter ("AL") 2632-E, filed February 23, 2005.

SUMMARY

In AL 2632-E, PG&E seeks approval of a three-year physical tolling agreement beginning in 2005 through December 2007 with Duke. This resolution approves PG&E's proposal. While neither PG&E nor Duke requested expedited treatment of this advice letter, due to summer reliability concerns, we have processed this advice letter on an expedited basis. Finally, the advice letter, including appendices, shall be kept confidential for a period of 6 months after which the advice letter in its entirety shall be made publicly available.

BACKGROUND

As explained in PG&E's advice letter filing, on October 11, 2004 Duke issued a Request For Bids (RFB) from qualified parties interested in purchasing the output from one or both of its Morro Bay Generation Units 3 and 4, 325 MW each, for up to three years beginning in 2005. On November 5, 2004, PG&E submitted non-binding three-year bids and was selected to the shortlist on November 15, 2004.

PG&E presented its proposed bid strategy to the Procurement Review Group on November 2, 2004, and details of the proposed transaction on December 14, 2004, and January 14, 2005.

NOTICE

Notice of PG&E AL 2632-E was made by publication in the Commission's Daily Calendar. PG&E states that a copy of the Advice Letter, excluding the confidential appendices (Appendices A, C & D), was mailed to the service list for R.01-10-024 and non-market participants who are members of PG&E's Procurement Review Group in accordance with General Order 96-A, Section III, Paragraph G.

PROTESTS

PG&E AL 2632-E was timely protested by Coastal Alliance on Plant Expansion ("CAPE"), City and County of San Francisco ("CCSF"), and City of Morro Bay ("City") on March 15, 2005. On March 17, the California Independent System Operator Corporation ("CAISO") filed a letter of support for PG&E's proposed contract with Duke.

The City and County of San Francisco's (CCSF) only comment on PG&E's proposed agreement relate to the need for PG&E to be mindful of its requirements imposed by Assembly Bill (AB) 117 to direct the investor-owned utilities ("IOUs") that energy procurement forecasts be made with community choice aggregation ("CCA") departing load in mind. CCSF reminds the commission that as it is currently crafting rules to comply with AB117 and its prohibition on cost shifting to utility bundled service customers, it is prudent for PG&E to plan for decreased energy procurement needs to serve San Francisco.

The California Independent System Operator ("CAISO") filed a letter of support for the proposed agreement, noting that the "...proposed transaction appears to provide PG&E with significant benefits, including the acquisition of capacity eligible for meeting its resource adequacy obligation..." in addition to deferring the retirement of Morro Bay Generation Units 3 and 4.

The Coastal Alliance on Plant Expansion ("CAPE") protests the AL because "...the facility does not currently possess authority to discharge heated cooling

water through its outfall and [because] Duke has shown no present intent to move forward with its application for a new National Pollutant Elimination Discharge System (“NPDES”) permit for Units 3 and 4.”¹ CAPE explains that Duke has filed an application for certification of a replacement plant with the California Energy Commission (“CEC”) for a new facility located on another portion of the site consisting of two new gas-fired turbines capable of generating up to 1,200 MW. Duke’s existing NPDES expired in 2000 and is currently on “administrative extension” by the Regional Water board with respect to its prior NPDES permit for the existing facility. CAPE further notes that Duke currently has yet to receive a new NPDES permit either for the new facility or the existing units. Further, Duke has not brought its facility into compliance with new regulations issued by the Environmental Protection Agency in 2004.

CAPE requests that if the commission does not reject the Agreement, it should require the terms of the agreement to be disclosed and the matter set for formal hearing.

The City of Morro Bay protests that PG&E is seeking approval of the proposed agreement with Duke through an advice letter process rather than formal hearings. Specifically, the City argues that: (1) PG&E did not properly serve or give notice of the advice letter, (2) the request violates the City’s statutory duty to protect sensitive “Tidelands Trust” property, (3) the advice letter contains material errors and omissions – specifically with respect to obligations owed by Duke to the City for ocean outfall, franchise obligations and natural gas surcharge fees, and (4) the proposed agreement is unjust, unreasonable or discriminatory.

The City’s protest is similar to CAPE’s with respect to the Tidelands Trust Property and the outfall lease. Both argue that the City’s responsibilities to protect the sensitive Tidelands Trust Property require an outfall lease with Duke that has yet to be renewed. A previous 50-year outfall lease expired in November 2004. The City questions whether the agreement for the output of the facilities’ power would require environmental review pursuant to the California Environmental Quality Act (“CEQA”).

¹ Protest by CAPE, p. 1

With respect to costs underlying the agreement, the City is concerned that the agreement may not protect the continued payment to the City of the electricity and gas franchise agreements between the City and PG&E, which generate as much as \$4 million annually to the City general fund. Further, the City is “concerned that the agreement does not adequately account for or fund Duke’s obligation to upgrade and modernize the facility, including Duke’s obligation to remove the smoke stacks.”²

As such, the City requests that the advice letter not be kept confidential and that the matter be resolved in a formal proceeding rather than through an advice letter process.

PG&E filed response to the protests on March 22, 2005. In its response, PG&E attaches a letter from Duke responding to the City’s and CAPE’s protest of the advice letter.

In response to CCSF’s protest, PG&E maintains that it is premature to remove potential CCSF CCA load from its load forecast at this time, or to conclude that Morro Bay is not needed to serve CCSF load. PG&E properly explains that until there is a conclusive decision by the San Francisco Local Agency Formation Commission, PG&E continues to have an obligation to serve all of its customers, including those of CCSF.

With respect to protest by the City of Morro Bay, PG&E clarifies that its agreement with Duke is a commercial agreement which does not change or alter existing agreements or obligations either PG&E or Duke have with the City. Except for dispatch instructions, which PG&E will be responsible for under the agreement, Duke continues to be responsible for the operations and maintenance of the units. For example, PG&E states that “the agreement does not modify the existing electric and gas franchise fee obligations from PG&E to Morro Bay, nor does it modify obligations pertaining to PG&E’s gas rate schedule G-SUR.”³

² Protest of the City of Morro Bay, p. 5

³ Response of PG&E, p. 3

With respect to environmental impacts, PG&E notes that its agreement with Duke is not a “project” for the purposes of CEQA, but continues an existing use of an existing facility which requires no review.

Finally, PG&E notes that it had served the advice letter in accordance to General Order 96-A to the service list in R.01-10-024 and to its Procurement Review Group.

No protests were filed from any members of the Procurement Review Group.

DISCUSSION

There are essentially five issues protested: (1) the need for consideration of departing load; (2) the need for an outfall lease; (3) the need to continue existing franchise fees obligations; (4) the need to disclose the agreement and not keep it confidential; and (5) the need for formal hearings. This resolution finds that it is premature to take into account CCSF CCA load, the agreement is approved. Finally, we find that there is no need for formal hearings.

Departing Load:

With respect to CCA departing load issues raised by CCSF, we agree that the commission, and PG&E, need to be mindful of potential departing load in making long-term procurement decisions. CCSF accurately points out that in the CCA proceeding, the commission, with CCSF’s active participation, is currently developing rules to comply with AB117. AB117 created the Community Choice Aggregation program and required that the commission establish a mechanism to prohibit costs being shifted onto utility bundled service customers as a result of CCA. CCSF’s concern that absent considering and taking into account the potential loss of CCSF CCA departing load, costs associated with the PG&E/Duke agreement could be imposed on CCSF customers. While we share that concern, we note that the contract in question is for a three-year period to end in 2007. This is a short enough time-frame to permit CCSF to finalize decisions on CCA formations while still permitting PG&E to enter into this agreement without jeopardizing CCSF’s CCA intentions. Further, comparing the notional cost of the Duke’s agreement with offers PG&E received from its

intermediate-term RFO, the cost of the Morro Bay units is the cheapest among others.⁴ We agree with PG&E that until there is more conclusive decisions made on behalf of CCSF regarding its authority to enter into a CCA arrangement, PG&E's obligations as an energy provider require it to continue to procure on behalf of its existing customer base.

Outfall Lease:

With respect to the outfall lease, we note that there is wide disagreement between the City and Duke on whether Duke is currently authorized to operate under an expired lease agreement with the City. The City and Duke acknowledge that the existing outfall lease agreement expired on November 14, 2004. However, Duke believes that its current arrangement permits it to operate the plant on a month-to-month basis. The City, however, believes that Duke is operating unlawfully.

While we cannot ignore the fact that there is legal dispute over the need for an existing outfall lease, we note that the dispute is between the City and Duke. PG&E's agreement with Duke includes provisions to make the contract null and void should the facility be unable to lawfully operate.⁵ We will approve the agreement with the understanding that the City and Duke will continue to work to resolve the lease issue in a manner that allows Duke to lawfully operate the units. While we encourage the City and Duke to resolve the outfall lease, our approval implies that Duke will be able to lawfully operate the units.

Franchise Fees Obligations:

With respect to existing franchise fees obligations, PG&E has stated in its response to the protest of the City that it will continue to honor its obligations and that the agreement does not modify such obligations. We agree. We find nothing in the agreement to suggest that PG&E is stepping away from its current obligations. In fact, the Master Power Purchase Agreement addresses existing obligations between parties other than Duke and PG&E. We will hold PG&E to their response and ask the City to inform us if PG&E's obligations are not met as a direct result of this agreement.

⁴ AL 2632-E, Confidential Appendix D, p.16

⁵ AL 2632-E, Confidential Appendix A, p. 12

Confidentiality and Need for Formal Hearings:

Finally, with respect to confidentiality protection and the need for formal hearings, the City argues that material errors were omitted that if revealed, would require formal hearings. In part, the City's concerns rest on the fact that the appendices to the advice letter were filed confidentially. In its advice letter, PG&E states that,

The portions of this advice letter so marked Confidential Protected Material are in accordance with the May 20, 2003, Modified Protective Order in R.01-10-024 Regarding Confidentiality of Pacific Gas and Electric Company Power Procurement Information. As required by that Order, reviewing representatives of market Participating Parties will not be granted access to Protected Material, but will instead be limited to reviewing redacted versions of documents that contain Protected Material.⁶ (AL, p.4)

Except for Appendix B (Duke's Request for Bids), PG&E seeks to keep all other appendices confidential, which include the executed agreement.

In comments to the draft resolution, PG&E raises concerns that releasing the advice letter, even under the protections adopted in the Modified Protective Order in R.01-10-024 could harm ratepayers by imposing potential cost increases and compromising PG&E's future negotiations. We are concerned that release of confidential information would have an undesirable affect on ratepayers. Given the need to ensure that sufficient resources are available this summer to avoid potential shortages, we must balance the harm to ratepayers and the state of California with the need to keep information confidential. As such, we shall keep the Advice Letter and appendices confidential for a period of 6 months after which we will publicly release the information. We believe that 6 months protects the interests of PG&E and its ratepayers while avoiding unwanted and unknown consequences.

⁶ AL 2632-E, p. 4

COMMENTS

Public Utilities Code section 311(g)(1) provides that this resolution must be served on all parties and subject to at least 30 days public review and comment prior to a vote of the Commission. Section 311(g)(2) provides that this 30-day period may be reduced or waived upon the stipulation of all parties in the proceeding:

The 30-day period may be reduced or waived in an unforeseen emergency situation, upon the stipulation of all parties in the proceeding, for an uncontested matter in which the decision grants the relief requested, or for an order seeking temporary injunctive relief.

Energy Division requests that the 30-day comment period for this resolution be reduced because a delay in approving the contract may prevent the facility from being available and online by June 2005. We are concerned that the reliability of the electrical grid may be compromised this summer if we do not ensure that adequate resources are available to meet peak demand.

Comments on the Draft Resolution E-3929 were filed by CAPE, Duke, PG&E, and the City of Morro Bay on April 4, 2005. The two primary issues addressed in comments related to the outfall lease and the confidentiality treatment of the Advice Letter filing. CAPE additionally filed protests based on procedural and substantive grounds.

PG&E simply notes that the draft resolution is correct that the outfall lease dispute is between the City and Duke. Accordingly, it offers suggested modifications to the draft resolution which would properly capture the dispute without compromising its agreement with Duke on the power output from the Morro Bay plant.

With respect to the confidentiality aspects of the draft resolution, PG&E raises a couple of concerns. The first relates to the potential exposure to ratepayers of releasing information contained in the PPA relating to the outfall lease. PG&E

notes that there are "...potential cost impacts on ratepayers associated with resolution of the dispute between the City of Morro Bay and Duke."⁷

The second relates to the release of two appendices to the advice letter dealing with PG&E internal memorandums to its Utility Risk Management and Risk Policy Committees. PG&E is concerned that confidential information contained in these appendices "...could compromise PG&E's future negotiating position and ultimately lead to higher costs for ratepayers."⁸

The City of Morro Bay's comments dealt only with the need to support the draft resolution. It notes that it will continue its efforts to work with Duke to resolve address its issues with respect to the outfall lease.

Duke comments primarily addressed the outfall lease. Its comments regarding the confidentiality aspect of the advice letter and the PPA were limited to the noting that the May 20, 2003, Administrative Law Judge's Ruling approving a Protective Order in the Procurement Rulemaking proceeding, R. 01-10-024, provided that certain commercially sensitive price and performance information be redacted.

With respect to the outfall lease, Duke has issues with the resolution's approval being contingent on resolution of necessary agreements between the City and Duke. Duke argues that approving the agreement contingent on resolution of the outfall lease will (1) create "...uncertainty about exactly when the Commission's approval becomes effective," (2) possibly not make the units available this summer, (3) give the City a significant advantage in its negotiations with Duke, and (4) duplicate, unnecessarily, existing terms of the PPA.

The resolution has adopted changes based on comments as reflected herein.

1. ⁷ PG&E Comments, p. 2

2. ⁸ PG&E Comments, p. 2

FINDINGS

1. By AL 2632-E, PG&E seeks approval of a three-year physical tolling agreement beginning in 2005 through December 2007 with Duke's Morro Bay Generation Units 3 and 4.
2. PG&E requests confidentiality for the terms of its agreement.
3. The City of San Francisco, the Coastal Alliance on Plant Expansion, and the City of Morro Bay filed timely protests on March 15, 2005.
4. The California Independent System Operator filed a letter of support on March 15, 2005.
5. PG&E filed timely responses to the protests on March 22, 2005.
6. The City's protest regarding existing obligations by PG&E owed to the City are not altered or changed by this agreement.
7. Duke's 50-year outfall lease expired on November 14, 2005.
8. The City and Duke have are in disagreement regarding the lawful operation of the units pursuant the outfall lease.
9. The City's protest regarding the confidentially aspect of AL 2632-E should be denied.
10. There is no need for the commission to proceed with a formal hearing.

THEREFORE IT IS ORDERED THAT:

1. The request of Pacific Gas & Electric Company (PG&E) for Commission approval of a three-year tolling agreement with Duke's Morro Bay Units 3 and 4 is approved. Our approval implies resolution of the outfall lease in a manner that allows Duke to lawfully operate the units.
2. The Advice Letter and appendices shall remain confidential for a period of 6 months after which it will be made publicly available in its entirety.

This Resolution is effective today.

I certify that the foregoing resolution was duly introduced, passed and adopted at a conference of the Public Utilities Commission of the State of California held on April 7, 2005; the following Commissioners voting favorably thereon:

STEVE LARSON
Executive Director

MICHAEL R. PEEVEY
PRESIDENT
GEOFFREY F. BROWN
SUSAN P. KENNEDY
DIAN M. GRUENEICH
Commissioners